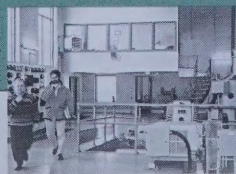
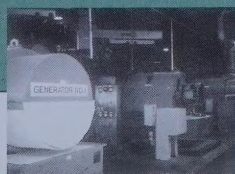


—STABILITY AND GROWTH WITH PURPOSE—



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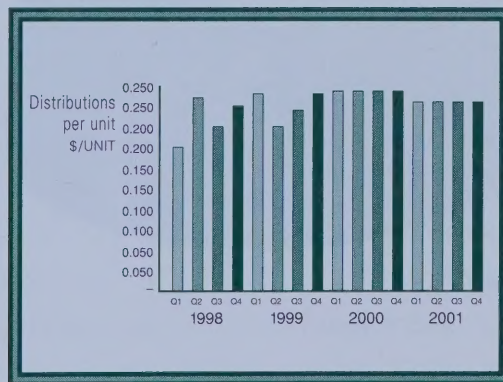
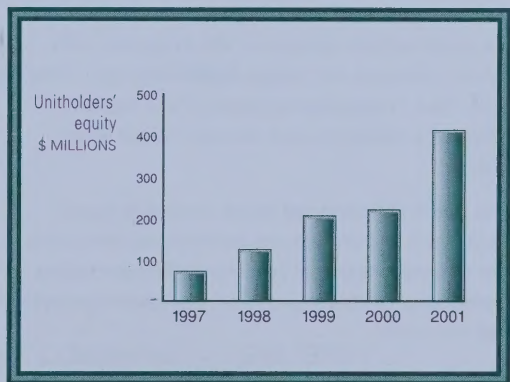
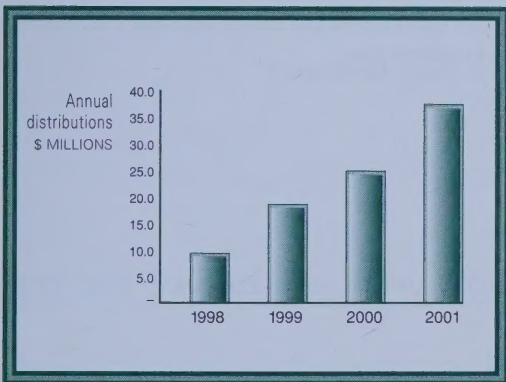
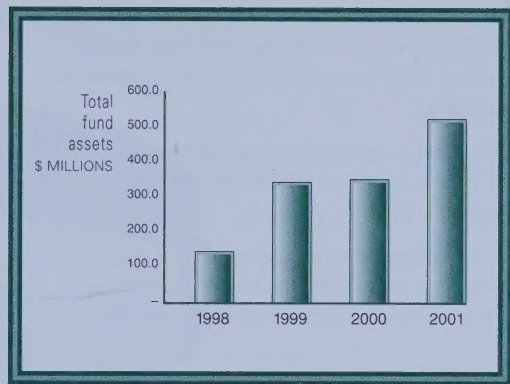
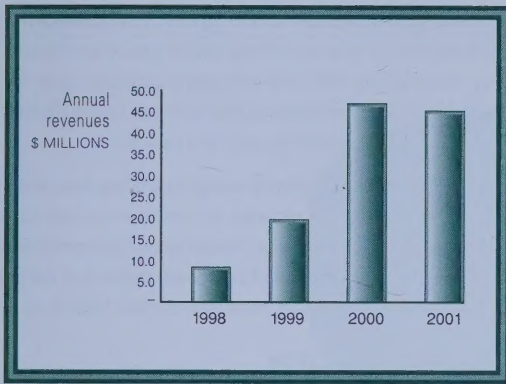




(THOUSANDS OF CANADIAN DOLLARS EXCEPT AS NOTED)

YEARS ENDED DECEMBER 31	2001	2000	1999	1998
<b>Statement of operations data</b>				
Energy sales	\$ 37,290	\$ 43,996	\$ 13,709	\$ 4,711
Waste treatment revenue	2,522	-	-	-
Other revenue	5,157	2,697	5,896	3,601
Total revenue	\$ 44,969	\$ 46,693	\$ 19,605	\$ 8,312
Net earnings	6,864	13,364	7,209	3,195
Net earnings per unit	0.17	0.54	0.37	0.29
Operating cash flow	29,578	22,537	13,329	7,031
Distributed cash	37,302	24,755	18,467	9,281
Distributions per unit	0.920	0.970	0.900	0.835
<b>Balance sheet data</b>				
Cash and cash equivalents	\$ 31,713	\$ 9,580	\$ 9,602	\$ 2,124
Working capital	19,011	2,024	(768)	(2,044)
Capital assets, and long-term investments	467,312	310,056	305,084	130,124
Total assets	512,384	328,502	325,988	135,096
Unitholders' equity	411,613	219,559	205,221	123,944
Number of trust units outstanding	50,875,772	27,020,472	24,020,472	14,090,472
Non-taxable portion of distribution to unitholders	71.52%	90.23%	95.79%	100%

## FINANCIAL HIGHLIGHTS



## PERFORMANCE COMPARATIVES



Seven hydroelectric generating facilities were acquired during 2001 to expand geographic diversification of the Fund. These facilities help to mitigate the risk of fluctuations that can result from natural, hydrologic conditions.

Disciplined investment in other generating assets provides an additional opportunity to enhance further the stability and sustainability of cash flows to unitholders.

During 2001, the Fund diversified its asset portfolio by acquiring interests in natural gas co-generation facilities, alternative fuel operations and infrastructure assets to build stable cash flows and growth.

## Alternative Fuels

The Fund acquired an interest in three biomass-fired generating facilities during 2001. These additions to the asset portfolio offer both long-term power purchase agreements with a regulated utility as well as access to adequate fuel supplies (wood) resulting in predictable cash flows. These generating assets offer a successful operating history and a solution to wood processors' wood waste disposal issues.

Biomass is one type of alternative fuel source. Biomass is organic matter that is burned in an incinerator and converted into combustible gas for greater efficiency and cleaner performance. Biomass sources include food processing, agricultural and forestry by-products as well as gas emitted from landfill.

Strategic partnerships were created, where required, to add management expertise to operate these facilities.

During 2001, the Fund also invested in the KMS Power Income Fund through a senior loan secured by the assets of KMS. KMS owns four generating facilities which burn waste, bio-gas and natural gas. These new technologies offer sustainable and stable cash flows and growth to existing unitholders as well as broad geographic diversification, new technologies, new markets and access to a wider regulatory environment. Subsequent to the end of the year, the Fund acquired 86.7% of the outstanding trust units and 47.3% of the outstanding convertible debentures of KMS. The Fund intends to acquire the remaining outstanding trust units of KMS.

## Natural Gas Co-generation

The Fund acquired an interest in three natural gas co-generation facilities. These assets offer long-term power purchase agreements with a regulated utility and matched long-term gas supply agreements resulting in predictable operating costs and cash flows.

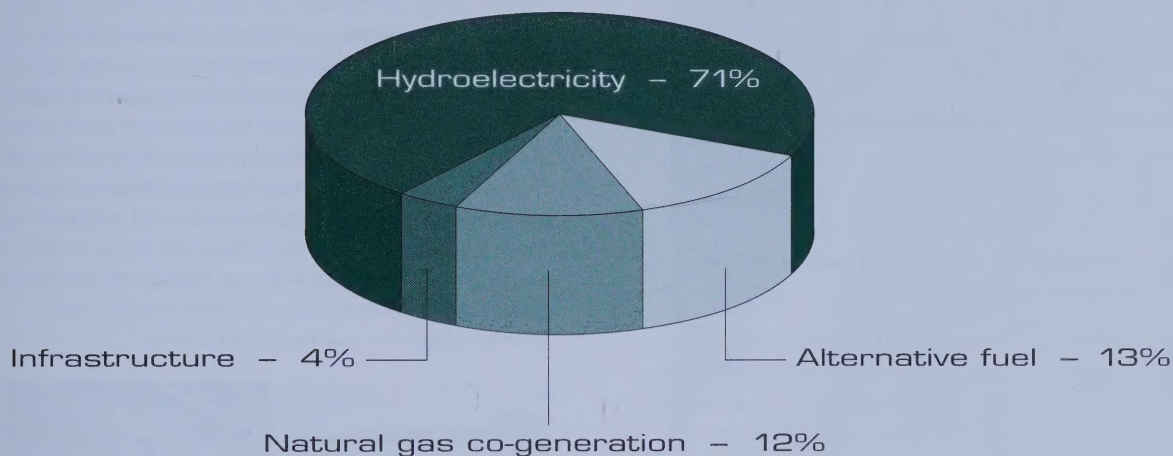
Co-generation is the use of primary energy to produce heat and electricity. It is based on the recovery and use of waste heat produced during the generation of electricity. Natural gas is the predominant fuel used in co-generation as a result of both lower capital and operating costs and its relative cleanliness compared to other fossil fuels.

## Infrastructure

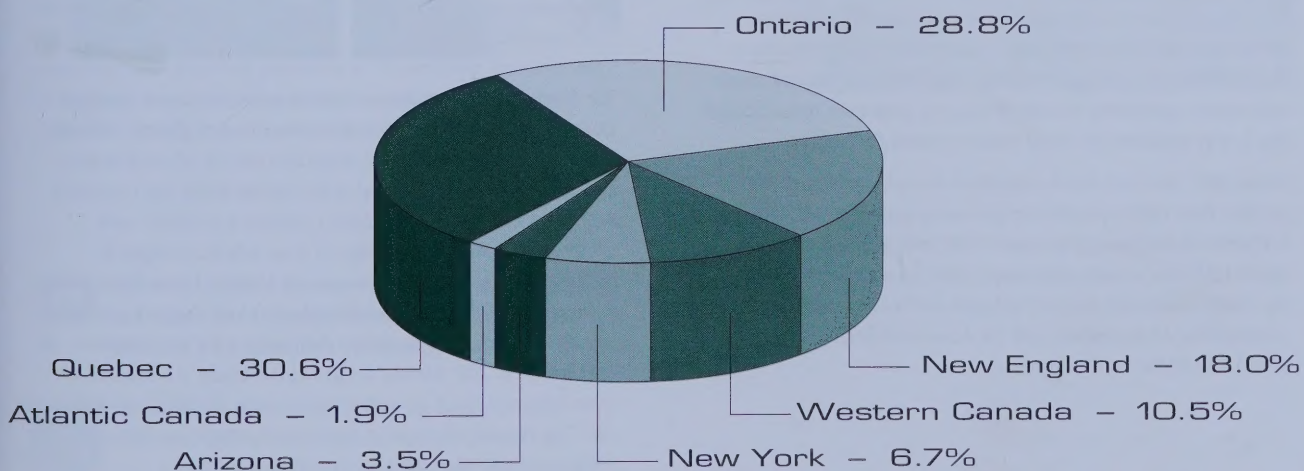
Infrastructure investments during 2001 included the acquisition of two wastewater treatment facilities in Arizona. These facilities, like natural gas co-generation and alternative fuel sources, offer highly predictable cash flows from a captive user base of more than 4,500 customers within a regulated utility.

## DIVERSIFICATION STRATEGY

## Portfolio Investment by Asset Category



## Portfolio Investment by Location



## DIVERSIFICATION STRATEGY



# Q&A

**Q Please explain the diversification strategy the Fund has been pursuing this year?**



The Fund has consistently provided stable distributions to unitholders. One of the key reasons for this success is the long-term cash flows derived from hydroelectric generation.

The Fund's "run of the river" hydroelectric generating facilities can, however, be affected by the risk of fluctuations that result from natural, hydrologic conditions. The diversification strategy has been formulated to balance such risks to provide long-term statistically predictable cash flows. Other renewable resource opportunities not dependent on weather tend to maintain a constant revenue flow during the same timeframe, providing a strong balancing effect that benefits unitholders.

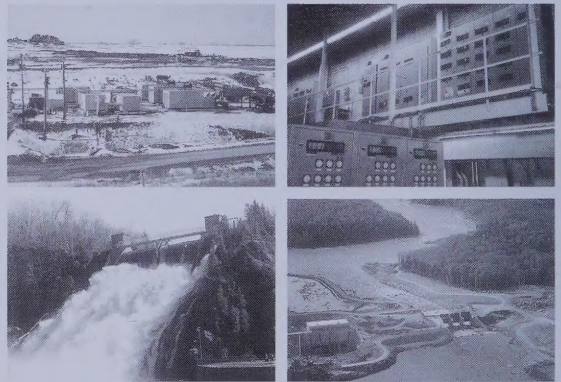
Alternative fuel (biomass) generating plants, natural gas co-generating facilities and infrastructure assets such as wastewater operations within regulated utilities have been acquired this year to implement this diversification strategy. In addition, the Fund also acquired seven hydroelectric generating facilities to increase geographic diversification that further mitigates the risk of weather-related fluctuations.

During 2001, the Fund was successful in diversifying its investment portfolio from 100% hydroelectric generating assets to 71%. Interests in alternative fuel generating assets (13%), natural gas co-generating assets (12%) and infrastructure assets (4%) were acquired to broaden the Fund's investment portfolio, enhance stability and support sustainability. All acquisitions met the Acquisition Guidelines established by the Fund's Trustees.

**Q Please explain the poor hydrologic conditions that adversely affected hydroelectric revenues and net earnings in 2001.**



The energy generated from a hydroelectric facility is dependent upon the hydrologic conditions which occur in the watershed in which the facility is located. Hydrologic conditions determine the river flow rate and are the result of the meteorological conditions which occur within the watershed basin. The predominant factor influencing hydrologic conditions is generally watershed precipitation, although temperature and evaporation within the watershed basin can also have a significant impact. In 2001, several regions in which the Fund owns facilities experienced drought or drought-like hydrologic conditions which adversely affected hydroelectric revenues and net earnings.

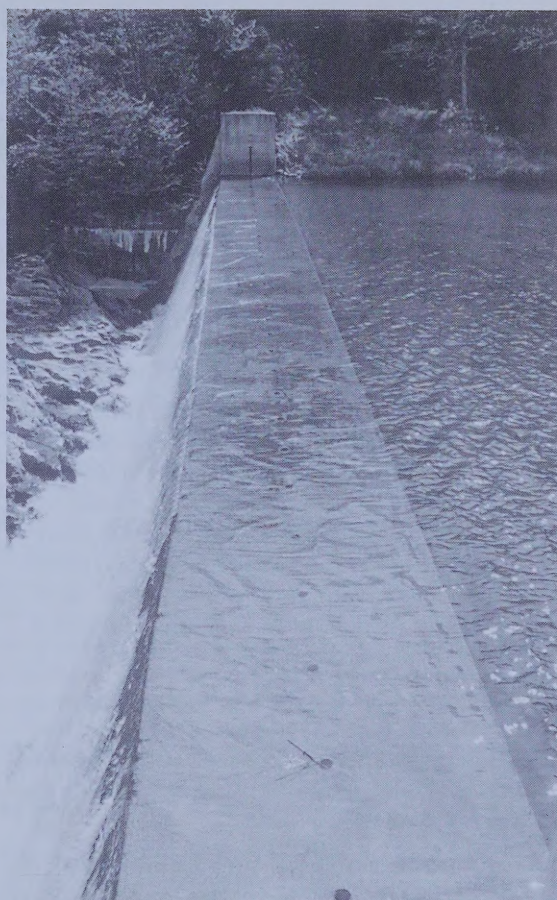


The Fund's Canadian assets are located in central Ontario, southern Quebec, coastal Newfoundland and central Alberta. Overall in Canada, precipitation and temperatures varied as a percent of the long term average conditions. But several of the regions where the Fund owns hydroelectric sites including Ontario, Quebec and Alberta were identified by Environment Canada as areas where shortages of rainfall were experienced in the summer of 2001. The rainfall shortage in Ontario and Quebec, where the majority of the assets are located, was an issue affecting generation from early in the year. However, the final quarter of 2001 showed a significant increase in production at these sites as a result of warmer than average temperatures in the Fall. This allowed precipitation that might normally have fallen as snow to instead reach the sites as usable river flows.

## QUESTIONS AND ANSWERS



In the United States, drought, or near-drought conditions existed in the New York, New Jersey and New Hampshire regions for the majority of the year. The U.S. National Drought Mitigation Center, operating from the University of Nebraska-Lincoln, has reported that the U.S. Drought Monitor has labelled all of New Hampshire, New Jersey and southern New York as a drought area and central New York State as a drought watch area. The Fund operates a total of 26 hydroelectric generating facilities in these three states. The dramatic labelling was the result of over a year of extremely low precipitation throughout these regions. While the second quarter produced promising production numbers from the U.S. assets, the flows were the result of early Summer precipitation across the regions that only resulted in a shift in production from the 3rd quarter to the 2nd quarter and was not sustainable.



## **Q** Will this diversification strategy continue?



The Fund remains committed to maintaining and improving the stability of distributions to unitholders. The Manager is focused on improving the performance of the existing asset base and acquiring assets that provide stable cash flow in accordance with established Acquisition Guidelines as stated in the Fund's latest prospectus. We plan to continue the disciplined growth strategy that began in 2001 by taking advantage of new and diversified opportunities that benefit unitholders. This strategy could include the acquisition of other sources of electricity generation or infrastructure assets as well as additional hydroelectric generating assets that provide strategic geographic and regulatory diversification.

## **Q** How effective were the acquired alternative fuel (biomass) and natural gas co-generation assets in mitigating the impact of poor hydrologic conditions in 2001?



These assets were acquired during the third and fourth quarters of 2001 and did not contribute for the full year. Their performance has been consistent with expectations. In the future, the Fund expects that these assets will balance the volatility inherent in small hydroelectric generating facilities.

## QUESTIONS AND ANSWERS



The Fund is a publicly traded Canadian income fund and an active consolidator of generating and infrastructure facilities in Canada and the United States. Market capitalization has grown from \$80 million in 1997 to \$529 million in 2001 as a result of its acquisition strategy. At December 31, 2001, the Fund had 50,875,772 trust units issued and outstanding and has interests directly or indirectly in 59 generating and wastewater treatment facilities.



## Significant Transactions

2001 was a very active year for the Fund as it completed three public offerings and raised gross proceeds of approximately \$235 million by issuing 23.9 million trust units. The net proceeds from the public offerings were used to pay down debt and to acquire investment interests which helped the Fund diversify its portfolio to include interests in alternative fuel generating assets, natural gas co-generating assets and infrastructure assets in addition to its hydroelectric generating facilities.

The Fund acquired interests in seven additional hydroelectric generating facilities to increase geographic diversification. The seven facilities have a total installed capacity of 25.6 megawatts. The facilities acquired are located in Ontario (1), Quebec (1), Alberta (1), New York (3) and Vermont (1).

The Fund initiated its diversification strategy to mitigate the impact of recent drought and drought-like conditions and low power purchase rates in the New York region by acquiring interests in three alternative fuel (biomass) generating facilities with a total installed capacity of 67 MW. The acquisition of investment interests in three natural gas-fired co-generation facilities with a total installed capacity of 290 MW further expanded the Fund's diversification.

The Fund's diversification strategy also included infrastructure facilities. Two wastewater facilities in Arizona with a combined base of 4,500 customers were acquired during 2001.

During the fourth quarter of 2001, the Fund entered into a loan arrangement with KMS Power Income Fund. KMS is a publicly traded income fund which owns one energy-from-waste generating facility in

Ontario, one bio-gas-fired generating facility in Illinois and two natural gas-fired co-generation facilities in New Jersey and Illinois. The Fund advanced \$35.0 million to KMS. (See discussion under Outlook regarding the Fund's acquisition of KMS units and convertible debentures.)

## Operating Results

For the year ended December 31, 2001, the Fund reported total revenues of \$45.0 million compared to \$46.7 million reported for 2000. 2001 earnings before loan repayment fees were \$13.6 million, consistent with 2000. Net earnings for 2001 were \$6.9 million compared to \$13.4 million in 2000. 2001 net earnings per trust unit were \$0.17 compared to \$0.54 in 2000.

Energy sales reported were \$37.3 million compared to \$44.0 million in 2000, a decline of 15%. The decline resulted from poor hydrologic conditions in the Fund's major regions and the fact that six hydroelectric facilities in New York State reverted to low current market rates at the beginning of the year. The decline in revenue was partially offset by the acquisition of interests in seven hydroelectric and one biomass-fired generating facilities during 2001 which contributed \$3.8 million. Incremental revenue from the three generating facilities acquired during 2000 contributed \$1.8 million. The chart below highlights energy revenues by region. The Fund also added \$2.5 million of wastewater treatment revenues as a result of the acquisition of two facilities in Arizona.

CONSOLIDATED ENERGY SALES	2001	2000
United States sites		
New York	4,945	11,325
New England	8,076	10,110
Subtotal	13,021	21,435
Canadian sites		
Quebec	14,733	15,100
Ontario	7,421	7,461
Alberta	2,115	
Subtotal	24,269	22,561
Total energy sales	37,290	43,996

## MANAGEMENT DISCUSSION AND ANALYSIS



Interest and dividend income totaled \$5.2 million compared to \$2.7 million in 2000, a 91% increase due to the addition of certain debt and participation interests and the Fund being in a positive cash position throughout the year due to the proceeds from the public offerings, partially offset by lower net revenues at the hydroelectric generating facilities accounted for on an equity basis. The Fund earned \$2.0 million from holding cash balances during the year.

2001 operating expenses increased by \$2.2 million over 2000 to \$14.8 million due to the addition of interests in eight facilities during 2001. Amortization costs were higher than the prior year due to the addition of more facilities during the year.

Overall administrative costs decreased during 2001 compared to 2000. Management fees were lower in 2001 as compared to 2000 because the Fund directly hired an employee from Algonquin Power Management Inc. (the "Manager") who is performing the daily accounting functions, causing the Manager's fee to be reduced and administrative expenses to increase by an equivalent amount. Administrative expenses were reduced during 2001 as a result of lower tax assessments in New York State.

During 2001, the Fund repaid the outstanding loan on the Cote Ste Catherine facility (\$28.7 million including a prepayment fee of \$6.8 million) to reduce debt and avoid future high rate interest expense. As a result, the Fund incurred a \$6.8 million prepayment charge against current year earnings. Proceeds from the public offering at the beginning of the year were utilized for the prepayment.

During the fourth quarter, the owner of the biomass generating facility in Alberta repaid its debt outstanding to a Fund entity along with a net prepayment fee of \$1.9 million. The net prepayment fee was recognized in income.

The Fund recorded total interest expense during 2001 of \$6.7 million, a reduction of \$2.2 million from 2000 as a result of the elimination of the Cote Ste Catherine debt. Currently, interest expense primarily represents project debt.

Operating cash flow before working capital adjustments during 2001 was \$22.2 million compared to \$23.2 million in 2000. Net earnings before the loan prepayment fee were consistent with 2000. Distributions to unitholders increased by \$12.5 million to \$37.3 million during 2001 as a result of additional trust units issued.

## Liquidity and Capital Reserves

As at December 31, 2001, the Fund had positive net working capital of \$19.0 million compared to \$2.0 million in 2000. At the end of 2001, the Fund had \$31.7 million of cash and cash equivalents. The excess of funds not distributed to unitholders will be invested by the Fund in revenue-producing assets in due course.

Long-term liabilities at December 31, 2001 were \$52.1 million compared to \$74.1 million in 2000. These long-term liabilities primarily represent the non-recourse project debt at Long Sault Rapids and Chute Ford. The project debt at Cote Ste Catherine was paid during the year.

## Risk Management

Due to the Fund's ownership of hydroelectric generating and infrastructure facilities in the United States, the Fund's results from operations are affected by the exchange rate between the Canadian and US dollars. The Fund has attempted to reduce the impact of exchange rate fluctuations by agreeing to pay certain of its obligations in US dollars. The management fees payable to the Manager of the Fund and the operations supervisory fees payable to Algonquin Power Systems Inc. are in US dollars. As well, the principal payments on certain promissory notes are payable in US dollars. Together, this has the effect of transferring much of the foreign exchange risk out of the Fund.

On an annual basis, the Fund utilizes currency options as required to hedge quarterly distributions and protect a minimum downside position. At the end of 2001, the Fund had no foreign exchange hedges in place.

At the beginning of 2001, six facilities in New York State reverted to current market rates either due to the expiry of the power purchase agreements or contract stipulations, exposing the Fund to fluctuating market rates. The Fund intends to enter into longer term power purchase agreements with respect to these facilities at the appropriate time.

## MANAGEMENT DISCUSSION AND ANALYSIS



## Outlook

2001 was a year of diversification for the Fund, as the Trustees and the Manager focused on broadening the Fund's investment portfolio to enhance the stability and sustainability of cash flows to unitholders. During 2001, the Fund added interests in alternative fuel (biomass) generating facilities, natural gas co-generation facilities and wastewater facilities. At the end of 2001 the Fund's asset portfolio based on initial investment values was composed of investment interests in hydroelectric generating facilities (71%), natural gas co-generating facilities (12%), alternative fuel (biomass) generating facilities (13%) and wastewater infrastructure facilities (4%).

The Fund will continue to consider investment opportunities which provide stable cash flow from generating and infrastructure facilities. Potential investment candidates could include co-generation and alternative fuel powered generating stations or wastewater facilities within a regulated utility. Opportunities which provide long-term, statistically predictable future cash flows whose risk profile is generally consistent with the existing portfolio of hydroelectric generating assets will be considered. All investment opportunities will continue to be required to meet the Fund's Acquisition Guidelines established by the Trustees. These guidelines provide that all acquisitions must be expected to result in an increase in distributable cash per trust unit.

The Fund will continue to grow through a combination of issuing units, raising capital and utilizing its line of credit. During the first quarter of 2002, the Fund has entered into an agreement with a major Canadian bank to increase its current line of credit from \$50.0 million to \$100.0 million.

At the beginning of March 2002, a Fund entity completed the acquisition of 86.7% of the outstanding trust units and 47.3% of the outstanding convertible debentures of KMS Power Income Fund. The offer consisted of the exchange of each KMS trust unit for .7428 Fund trust units and each \$100 of KMS convertible debentures for 10.34 Fund trust units. This transaction resulted in the Fund issuing a total of 6,099,557 trust units. The Fund intends to exercise its rights under KMS' trust declaration and effect a subsequent acquisition transaction so as to acquire the remaining KMS trust units not tendered under the offer. This will result in the Fund issuing an additional 713,616 trust units.

## MANAGEMENT DISCUSSION AND ANALYSIS



## Recently Issued Accounting Standards

During 2001, the Canadian Institute of Chartered Accountants ("CICA") issued new Handbook Sections 1581, "Business Combinations" ("Section 1581") and Handbook Section 3062, "Goodwill and Other Intangible Assets" ("Section 3062"). Section 1581 requires that the purchase method of accounting be used for all business combinations. Section 1581 specifies criteria that intangible assets acquired in a business combination must meet to be recognized and reported separately from goodwill. Section 3062 will require that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually by comparing carrying value to the respective fair value in accordance with the provisions of Section 3062. Section 3062 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment by assessing the recoverability of the carrying value. The Company adopted the provisions of Section 1581 as of July 1, 2001, and Section 3062 is effective January 1, 2002.

Also in 2001, the CICA amended Handbook Section 1650, "Foreign Currency Translation" ("Section 1650") and issued Accounting Guideline 13, "Hedging Relationships" ("AcG 13"). The revision to Section 1650 eliminates the deferral and amortization of foreign currency translation differences resulting from the translation of long-term monetary assets and liabilities denominated in foreign currencies. All such translation differences will be charged directly to income. Section 1650 will be in effect as of January 1, 2002. Accounting Guideline 13 establishes new criteria for hedge accounting and will apply to all hedging relationships in effect on or after January 1, 2003.

In December 2001, Handbook Section 3870, Stock-based Compensation and Other Stock-based Payments ("Section 3870") was issued. Section 3870 establishes standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services provided by employees and non-employees. It applies to transactions in which shares of common stock, stock options or other equity instruments are granted or liabilities incurred based on the price of common stock or other equity instruments. Section 3870 sets out a fair value based method of accounting that is required for certain, but not all, stock-based transactions.

The Fund does not believe that the adoption of these standards will have a material impact on the Fund's financial condition or results of operations and anticipates no transitional impact to the historic financial statements from adoption of these standards.

## Quarterly Financial Information

The following is a summary of unaudited quarterly financial information for the two years ended December 31, 2001.

2001	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	TOTAL
Revenues	10.50	12.90	8.10	13.50	45.00
Net earnings (loss)	3.80	(2.50)	1.80	3.80	6.90
Net earnings per trust unit	0.11	(0.08)	0.05	0.09	0.17
<b>2000</b>					
Revenues	12.60	14.10	8.80	11.20	46.70
Net earnings	3.70	5.80	1.20	2.70	13.40
Net earnings per trust unit	0.15	0.24	0.05	0.10	0.54

(\$ MILLIONS EXCEPT PER TRUST UNIT AMOUNTS)

## MANAGEMENT DISCUSSION AND ANALYSIS

## Auditor's Report to the Unitholders

We have audited the consolidated balance sheets of Algonquin Power Income Fund as at December 31, 2001 and 2000 and the consolidated statements of earnings and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*KPMG LLP*

Chartered Accountants  
Toronto, Canada

February 15, 2002  
(except note 16 which is as of March 11, 2002)

AUDITOR'S REPORT



# Consolidated Balance Sheets

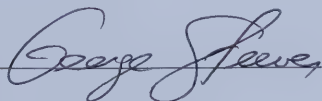
## December 31, 2001 and December 31, 2000

(THOUSANDS OF CANADIAN DOLLARS)

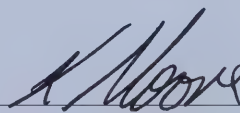
	2001	2000
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 31,713	\$ 9,580
Accounts receivable	8,864	5,828
Prepaid expenses	477	491
Current portion of notes receivable (note 3)	1,176	1,840
Future income tax asset (note 8)	216	217
	<u>42,446</u>	<u>17,956</u>
<b>Long term investments (note 3)</b>	107,099	16,195
<b>Capital assets, net of amortization (note 4)</b>	359,037	292,021
<b>Funds held in reserve</b>	3,210	1,696
<b>Deferred costs</b>	592	634
	<u>\$ 512,384</u>	<u>\$ 328,502</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 7,757	\$ 4,274
Due to Algonquin Power Group	2,324	1,887
Cash distribution payable	11,701	6,552
Current portion of long-term liabilities (note 6)	498	994
Current income tax liability	618	419
Future income tax liability (note 8)	537	1,806
	<u>23,435</u>	<u>15,932</u>
<b>Long-term liabilities (note 6)</b>	51,577	73,121
<b>Future non-current income tax liability (note 8)</b>	25,759	19,890
<b>Unitholders' equity</b>		
<b>Trust units (note 7)</b>	473,013	250,521
<b>Deficit</b>	(61,400)	(30,962)
	<u>411,613</u>	<u>219,559</u>
Commitments and contingencies (note 10)		
	<u>\$ 512,384</u>	<u>\$ 328,502</u>

Approved by the Trustees:

Trustee



Trustee



BALANCE SHEETS

# Consolidated Statements of Earnings and Deficit

For the years ended:  
December 31, 2001 and December 31, 2000

(THOUSANDS OF CANADIAN DOLLARS)

	2001	2000
<b>Revenue</b>		
Energy sales	\$ 37,290	\$ 43,996
Water treatment revenue	2,522	-
Interest and dividend income	5,157	2,697
	<u>44,969</u>	<u>46,693</u>
<b>Expenses</b>		
Operating (note 9)	14,829	12,587
Amortization	10,231	8,621
Management fees (note 9)	337	408
Administrative expenses	792	1,299
Withholding taxes	472	200
Gain on foreign exchange	(354)	(359)
	<u>26,307</u>	<u>22,756</u>
<b>Earnings before under noted</b>	18,662	23,937
Interest expense	6,700	8,947
Loan payment fee	6,751	-
Income from note receivable prepayment	(1,890)	-
	<u>11,561</u>	<u>8,947</u>
<b>Earnings before income taxes</b>	7,101	14,990
<b>Provision for (recovery of) income taxes (note 8)</b>		
Current income taxes	391	710
Future income taxes	(154)	916
	<u>237</u>	<u>1,626</u>
<b>Net earnings</b>	6,864	13,364
<b>Deficit, beginning of year</b>	(30,962)	(19,571)
Cash distributions (note 12)	(37,302)	(24,755)
<b>Deficit, end of year</b>	<u>\$ (61,400)</u>	<u>\$ (30,962)</u>
<b>Net earnings per trust unit (note 13)</b>	<u>\$ 0.17</u>	<u>\$ 0.54</u>

## STATEMENTS OF EARNINGS AND DEFICIT



# Consolidated Statements of Cash Flows

For the years ended:

December 31, 2001 and December 31, 2000

(THOUSANDS OF CANADIAN DOLLARS)

	2001	2000
<b>Operating activities</b>		
Net earnings	\$ 6,864	\$ 13,364
Items not affecting cash		
Amortization of capital assets	10,231	8,621
Other amortization	640	685
Distribution received in excess of equity income	163	62
Future income taxes	(154)	916
Loan prepayment fee	6,751	-
Income from note receivable prepayment	(1,890)	-
Gain on foreign exchange	(432)	(428)
	22,173	23,220
Changes in non-cash operating working capital	7,405	(683)
	29,578	22,537
<b>Financing activities</b>		
Cash distributions	(37,302)	(24,755)
Drawdown of revolving credit facility	-	(6,911)
Issue of trust units	235,150	27,450
Expenses of trust units offerings	(12,658)	(1,721)
Financing fee	(50)	(18)
Loan prepayment	(6,751)	-
Repayment of long-term liabilities	(22,702)	(3,753)
	155,687	(9,708)
<b>Investing activities</b>		
Increase in funds held in reserve	593	218
Receipt of principal on notes receivable	23,238	229
Acquisition of notes receivable and shares (note 2)	(74,534)	-
Addition to capital assets	(2,917)	(569)
Acquisition of operating entities (note 2)	(76,885)	(12,814)
KMS financing (note 2)	(35,000)	-
Receipt of financing fee	350	-
Income from note receivable prepayment	1,890	-
	(163,265)	(12,936)
Effect of exchange rate differences on cash and cash equivalents	133	85
Increase (decrease) in cash and cash equivalents	22,133	(22)
Cash and cash equivalents, beginning of year	9,580	9,602
Cash and cash equivalents, end of year	\$ 31,713	\$ 9,580
Supplemental disclosure of cash flow information		
Cash paid during the year for interest expense	\$ 6,594	\$ 8,225
Cash paid during the year for income taxes	\$ 191	\$ 288

## STATEMENTS OF CASH FLOWS

Algonquin Power Income Fund is an open-ended, unincorporated trust established pursuant to the Declaration of Trust dated September 8, 1997, as amended, under the laws of the Province of Ontario. The Fund's principal business activity is the ownership, directly or indirectly, of generating and infrastructure facilities.

The Fund is managed by Algonquin Power Management Inc. ("AMI"), a company wholly owned by the shareholders of Algonquin Power Corporation Inc. ("APC"). A subsidiary of APC, Algonquin Power Systems Inc. ("APS"), operates the hydroelectric facilities on a day-to-day basis. Algonquin Power Acquisition Partnership, a partnership ultimately owned by APC, provides consulting services to the Fund. Newspring Water LLC ("Newspring"), a partnership jointly owned by APC and a third party, manage and operate the wastewater treatment facilities in Arizona. Collectively, these entities are referred to as the Algonquin Power Group.

## 1. Significant accounting policies

### (a) Basis of consolidation

The consolidated financial statements of the Fund have been prepared in accordance with accounting principles generally accepted in Canada, and include the consolidated accounts of all of its subsidiaries. The Fund consolidates its proportionate share in the Campbellford Limited Partnership and the Valley Power Limited Partnership.

All significant intercompany transactions and balances have been eliminated.

### (b) Cash and cash equivalents

Cash and cash equivalents include cash deposited at banks and highly liquid investments with original maturities of 90 days or less.

### (c) Funds held in reserve

Cash reserves segregated from the Fund's cash balances are maintained in accounts administered by a separate agent and are disclosed separately in these consolidated financial statements because the Fund cannot access this cash without the prior authorization of parties not related to the Fund.

### (d) Capital assets

Capital assets, being land, facilities together with related power purchase contracts and equipment, hydro contract acquisition costs and licences and agreements are recorded at cost. Development costs, including the cost of acquiring or constructing facilities together with the related interest costs during the period of construction are capitalized. Improvements that increase or prolong the service life or capacity of an asset are capitalized. Maintenance and repair costs are expensed as incurred.

The facilities are amortized on a straight-line basis over the estimated useful lives of the facilities. These periods range from 18 to 40 years. Facility equipment is amortized over 5 years.

The costs attributable to establishing exemptions from Federal Energy Regulatory Commission licensing requirements in the United States are being amortized on a straight-line basis over five years.

Hydro contract acquisition costs are amortized over 6 years.

### (e) Notes receivable

Notes receivable are carried at cost. A provision for credit losses on notes receivable is charged to the statement of earnings and deficit to cover any losses of principal and accrued interest.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*(f) Deferred costs*

Deferred costs, which include the costs of arranging the credit facility, have been deferred and are amortized over the term of the expected benefit.

*(g) Long-term investments*

Investments in which the Fund has significant influence but not control or joint control are accounted for using the equity method. The Fund records its share in the income or loss of its investees in interest and dividend income in the consolidated statement of earnings and deficit. All other equity investments are accounted for under the cost method. Under the cost method of accounting, investments are carried at cost and are adjusted only for other-than-temporary declines in fair value, distributions of earnings and additional investments.

*(h) Recognition of revenue*

Revenue derived from energy sales, which are mostly under long-term power purchase contracts, is recorded at the time electrical energy is delivered.

Wastewater treatment revenues are recorded when billed to customers.

Interest and dividend income from long-term investments is recorded as earned.

*(i) Foreign currency translation*

The Fund's United States' subsidiaries and partnership interests are considered to be functionally integrated with the Canadian operations. All monetary assets and liabilities denominated in United States dollars are translated into Canadian dollars at year end exchange rates, whereas non-monetary assets and liabilities are translated at the rate in effect at the transaction date. The revenues and expenses of these integrated operations are translated at the average rate of exchange in effect during the period. The foreign currency translation adjustment is reflected in the consolidated statement of earnings and deficit.

*(j) Income taxes*

As the Fund is an unincorporated trust, it is entitled to deduct distributions to unitholders to the extent of its taxable income and consequently, it is expected that the Fund will not be liable for any material income tax as this will be the responsibility of the individual unitholder. Any provision for income taxes will relate solely to the income taxes of the Fund's wholly owned subsidiaries.

Income taxes are accounted for using the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

*(k) Use of estimates*

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of these financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from estimates. During the years presented, management has made a number of estimates and valuation assumptions, including the useful lives and recoverability of capital assets, the recoverability of notes receivable and long-term investments, the recoverability of future tax assets and the fair value of financial assets and liabilities. These estimates and valuation assumptions are based on present conditions and management's planned course of action, as well as assumptions about future business and economic conditions. Should the underlying valuation assumptions and estimates change, the recorded amounts could change by a material amount.

*(l) Comparative figures*

Certain comparative figures have been reclassified to conform to the current year presentation.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS



## 2. Acquisitions

### (a) Acquisitions of facilities

During 2001, the Fund acquired two wastewater treatment facilities, six hydroelectric generating facilities, a note receivable and a 50% interest in a hydroelectric generating facility and 50% ownership of a biomass-fired generating facility for total consideration of \$76,885. The acquisitions have been accounted for using the purchase method with earnings from operations included since the date of acquisition. The consideration paid by the Fund has been allocated to net assets acquired as follows:

Working capital	\$	1,379
Capital assets		74,330
Funds held in reserve		2,107
Note receivable		3,680
Future non-current tax asset		802
Future non-current income tax liability		(5,413)
Total cash purchase price paid	\$	<u>76,885</u>

The purchase price paid for the facilities, the nature of the acquisitions and the dates of acquisition are set out in the table below:

FACILITY	PURCHASE PRICE	NATURE OF ACQUISITION	DATE OF ACQUISITION
Phoenix Hydro, Kings Falls and Otter Creek, New York State and Worcester Hydro, Vermont	\$ 11,614	Shares	March 21, 2001
Campbellford, Ontario	8,151	Partnership interest and note receivable	March 9, 2001 and April 1, 2001
St Raphael de Belchasse, Quebec	905	Shares	April 11, 2001
Black Mountain Sewer, Arizona	6,782	Shares	March 16, 2001
Gold Canyon Sewer, Arizona	7,315	Shares	July 9, 2001
Dickson Dam and 50% of Valley Power, Alberta	42,118	Trust units	July 27, 2001
Total	\$ <u>76,885</u>		

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

During 2000, the Fund acquired a 100% interest in three hydroelectric generating facilities from the Algonquin Power Group for total consideration of \$12,978. The acquisitions have been accounted for using the purchase method with earnings from operations included since the date of acquisition. The consideration paid by the Fund has been allocated to net assets acquired as follows:

Working capital	\$ 165
Capital assets	<u>12,813</u>
Total purchase price	12,978
Less: cash acquired	<u>(164)</u>
Cash paid, net of cash acquired	<u>\$ 12,814</u>

The purchase price paid for each facility, the nature of the acquisitions and the dates of acquisition are set out in the table below:

FACILITY	PURCHASE PRICE	NATURE OF ACQUISITION	DATE OF ACQUISITION
Milton Mills, New Hampshire	\$ 2,618	Shares and management agreement	July 11, 2000
Mine Falls, New Hampshire	4,905	Partnership	September 6, 2000
Great Falls, New Jersey	<u>5,455</u>	Partnership	September 15, 2000
Total	<u>\$ 12,978</u>		

*(b) Acquisition of notes receivable and shares*

During the fourth quarter of 2001, the Fund acquired certain notes receivable and equity shares in six generating facilities for a total of \$74,534. These included three biomass-fired generating facilities in Alberta, Quebec and Nova Scotia and three gas-fired co-generation facilities located in Ontario.

Subsequent to the completion of this transaction the owner of one facility, a biomass facility located in Alberta, repaid the outstanding loan plus a prepayment penalty. The Fund has no further interest in this facility.

*(c) Other*

- i) During the fourth quarter of 2001, the Fund entered into a loan agreement with KMS Power Income Fund. The Fund advanced \$35,000 at an interest rate of 5.568% above prime (see note 16).
- ii) The Fund has acquired from the Algonquin Power Group the 50% interest in the Campbellford Limited Partnership, St Raphael de Bellchasse, Phoenix Hydro, Otter Creek, Kings Falls, Worcester Hydro and Black Mountain Sewer for a total of \$20,101. In addition, the Fund has paid the Algonquin Power Group fees totalling \$2,178 for the acquisition of Dickson Dam, Valley Power, Gold Canyon Sewer and the acquisition of notes receivable and shares in six generating facilities, representing a total transaction value of \$123,967.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 3. Long-term investments

	2001	2000
Debt and share interests in five generating facilities, ranging from 12.1% to 32.4% interests	\$ 57,788	\$ -
A 45% partnership interest in the Algonquin Power (Rattle Brook) Partnership	3,937	4,100
	61,725	4,100
KMS Loan		
Interest at a floating rate of 5.568% above prime. Payments consist of interest only prior to maturity. Maturity is expected to be November 2004	35,000	-
APC Note		
9.25% secured note, repaid in 2001	-	6,402
Franklin Note		
11.05% senior secured note due January 1, 2006 principal amount of US\$6,200	7,996	7,533
Campbellford Note		
Note bearing interest of 9.9415% repayable in monthly blended installments of \$32, maturing February 28, 2015	3,554	-
	46,550	13,935
	108,275	18,035
Less: current portion	1,176	1,840
	\$ 107,099	\$ 16,195

The above notes are secured by the underlying assets of the respective facilities.

### 4. Capital assets

		2001 ACCUMULATED AMORTIZATION	2000 NET BOOK VALUE	2000 NET BOOK VALUE
	COST			
Land	\$ 1,338	\$ -	\$ 1,338	\$ 261
Facilities	378,780	23,000	355,780	289,387
Hydro contract acquisition costs	1,442	981	461	692
Licenses and agreements	1,879	421	1,458	1,681
	\$ 383,439	\$ 24,402	\$ 359,037	\$ 292,021

Facilities include \$92,439 (2000 - \$92,823) of assets under capital lease.

### 5. Revolving credit facility

The Fund has negotiated a \$50 million revolving credit facility with a major Canadian bank which matures September 30, 2002. Under the terms of the revolving credit facility, the Fund may acquire generating or infrastructure facilities which meet the Fund's acquisition guidelines. At December 31, 2001, the Fund has not drawn any funds (2000 - \$0) on the facility, with the exception of certain letters of guarantee totaling \$4,174, posted as security. The terms of the credit agreement require the Fund to pay a standby charge of 0.35% on the unused portion of the revolving credit facility and maintain certain financial covenants. The facility is secured by a fixed and floating charge over all Fund entities.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS



## 6. Long-term liabilities

	2001	2000
Senior Debt Cote Ste-Catherine Interest at rates varying from 9.91% to 11.05% repayable in monthly blended installments of \$235. The loan was repaid in 2001.	\$ -	\$ 22,189
Senior Debt Long Sault Rapids Interest at rates varying from 10.16% to 10.21% repayable in monthly blended installments of \$401, maturing December 2028.	44,397	44,692
Senior Debt Chute Ford Interest rate of 11.55% repayable in monthly blended installments of \$64, maturing April 2020.	5,804	5,892
Other	1,874	1,342
	<u>\$ 52,075</u>	<u>\$ 74,115</u>
Less: current portion	(498)	(994)
	<u>\$ 51,577</u>	<u>\$ 73,121</u>

Each of the senior debt is secured by the respective facility with no other recourse to the Fund. The loans have certain financial covenants which must be maintained on a quarterly basis.

Principal payments due in the next five years are:	2002	\$ 498
	2003	521
	2004	798
	2005	580
	2006	644
	Thereafter	49,078
		<u>\$ 52,119</u>
Less: Imputed interest		(44)
		<u>\$ 52,075</u>

## 7. Trust units

### Authorized trust units

The Declaration of Trust provides that an unlimited number of trust units may be issued. Each trust unit represents an undivided beneficial interest in any distribution from the Fund and in the net assets in the event of termination or wind-up. All trust units are of the same class with equal rights and privileges.

Trust units are redeemable at the holder's option at amounts related to market prices at the time subject to a maximum of \$250 in cash redemptions in any particular calendar month. Redemptions in excess of this amount shall be paid by way of a distribution in specie of a pro rata amount of certain of the Fund's assets, including the securities purchased by the Fund, but not to include the generating facilities.

ISSUED TRUST UNITS	NUMBER OF TRUST UNITS	AMOUNT
Balance as at December 31, 1999	24,020,472	\$ 224,792
Issued during the year for cash	3,000,000	27,450
Cost of issue		(1,721)
Balance as at December 31, 2000	27,020,472	250,521
Issued during the year for cash	23,855,300	235,150
Cost of issues		(12,658)
Balance as at December 31, 2001	<u>50,875,772</u>	<u>\$ 473,013</u>

The Fund completed three public offerings in 2001 and one public offering in 2000.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 8. Income taxes

The provision for income taxes in the consolidated statements of earnings represents an effective tax rate different than the Canadian statutory rate of 38.0% (2000 - 40.0%). The differences are as follows:

	2001	2000
Earnings before income tax	\$ 7,101	\$ 14,990
Computed income tax expense at Canadian statutory rate	2,698	5,996
Increase (decrease) resulting from:		
Income of trust distributed directly to unitholders	(1,269)	(3,204)
Change in substantively enacted tax rate	(660)	(2,161)
Manufacturing and processing deduction	(95)	(86)
Large corporations tax	112	127
Other	(549)	954
Income tax expense	\$ 237	\$ 1,626

The tax effect of temporary differences at the Fund's subsidiaries that give rise to significant portions of the future tax assets and future tax liabilities at December 31, 2001 and 2000 are presented below:

	2001	2000
Future tax assets:		
Non-capital loss, debt restructuring charges and non-deductible interest carryforwards	\$ 3,221	\$ 851
Total future tax assets	3,221	851
Future tax liabilities:		
Capital assets – differences between net book value and undepreciated capital cost	(29,301)	(22,010)
Other	-	(320)
Total future tax liabilities	(29,301)	(22,330)
Net future tax liability	\$ (26,080)	\$ (21,479)
Classified in the financial statements as:		
Future current income tax asset	\$ 216	\$ (217)
Future current income tax liability	(537)	(1,806)
Future non-current income tax liability	(25,759)	(19,890)
	\$ (26,080)	\$ (21,479)

At December 31, 2001, the Fund itself has financing expenses and underwriters' fees of \$16,889 (2000 - \$10,589) which will be deductible by the Fund and, which will reduce the ultimate amount taxable to the unitholders over the next four years. This will be offset by additions to the unitholders' taxable income since the Fund's capital assets have an accounting basis which exceeds their tax basis by \$3,265 (2000 - \$2,455). In addition a trust wholly owned by the Fund has capital assets having an accounting basis which exceeds their tax basis by \$1,602 (2000 - \$520).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 9. Algonquin Power Group

### *(a) Management agreement*

The Fund has entered into a management agreement with AMI. The management services to be provided include advice and consultation concerning business planning, support, guidance and policy making and general management services. The management agreement provides for an incentive fee if certain targets are met, which were not achieved in 2001 and 2000. During 2001, management fees of \$337 (2000 - \$408) were incurred.

### *(b) Operations*

The Fund has entered into an operations supervisory agreement with APS. The operations supervisory services to be provided include the planning of capital repairs, compliance monitoring for environmental permits and administration of power purchase agreements.

In addition, each of the hydroelectric generating facilities of the operating entities has entered into a direct operations contract with APS. The direct operations contracts provide for the day-to-day services required to operate and maintain each hydroelectric generating facility. Payments under these contracts typically have a fixed fee and variable component. The variable fee is either linked to gross revenue or gross revenue less direct operating costs.

During 2001, APS charged \$7,054 (2000 - \$7,623) in operations fees, which included operations supervisory fees of \$309 (2000 - \$308).

### *(c) Wastewater*

The wastewater treatment facilities have entered into direct operations contracts with Newspring. The direct operations contracts provide for the day-to-day services required to operate and maintain the facilities.

During 2001 Newspring charged \$418 (2000 - \$0) in operations fees.

## 10. Commitments and contingencies

### *(a) Land and water leases*

Each of the operating entities has entered into agreements to lease either the land and/or the water rights for the hydroelectric generating facility or to pay in lieu of property tax an amount based on electricity production. These payments typically have a fixed and variable component. The variable fee is generally linked to actual power production or gross revenue. The Fund incurred \$2,293 during 2001 (2000 - \$2,571) in respect of these agreements for the consolidated facilities. For the facilities that generate interest income and income from participation agreements, there were land and water lease payments of \$47 in 2001 (2000 - \$27).

### *(b) Contingencies*

The Fund and its subsidiaries are involved in various claims and litigation arising out of the ordinary course and conduct of its business. Although such matters cannot be predicted with certainty, management does not consider the Fund's exposure to such litigation to be material to these financial statements.



### 11. Financial instruments

The carrying amount of the Fund's cash and cash equivalents, accounts receivable, funds held in reserve, accounts payable, accrued liabilities, due to Algonquin Power Group and cash distribution payable, approximate fair market value due to the short term nature of these financial instruments.

The carrying amount of the Fund's long-term investments is dependant on the underlying operations and accordingly a fair value is not readily available. The Fund has long-term debt at fixed interest rates. The fair value of these loans at current rates would be \$64,052.

### 12. Cash distributions

Distributable income, as defined in the Declaration of Trust, is distributed to unitholders of record on the last day of each calendar quarter on or before the 45th day of the following calendar quarter.

Distributions per trust unit declared by the Trustees in 2001 and 2000 were as follows:

	2001	2000
First quarter	\$ 0.2300	\$ 0.2425
Second quarter	\$ 0.2300	\$ 0.2425
Third quarter	\$ 0.2300	\$ 0.2425
Fourth quarter	\$ 0.2300	\$ 0.2425

### 13. Net earnings per trust unit

Net earnings per trust unit have been calculated using the weighted average number of trust units outstanding during the year. The weighted average number of trust units outstanding for 2001 was 39,524,548 (2000 – 24,867,047).

### 14. Segmented information

	2001	2000
Revenues		
Canada	\$ 28,845	\$ 24,125
United States	16,123	22,568
	<u>\$ 44,969</u>	<u>\$ 46,693</u>
Capital Assets		
Canada	\$ 262,696	\$ 224,784
United States	96,341	67,237
	<u>\$ 359,037</u>	<u>\$ 292,021</u>

Revenues are attributable to the two countries based on the location of the underlying generating and infrastructure facilities.

All energy sales are earned from contracts with large public utilities. The following utilities contributed more than 10% of these total revenues: Niagara Mohawk Power Corporation 10% (2000-25%), Ontario Electricity Financial Corporation 19% (2000 – 16%), Public Service of New Hampshire 23% (2000-24%), and Hydro Québec 38% (2000-33%). The Fund has mitigated its credit risk to the extent possible by selling energy to these large utilities in various North American locations.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### 15. Joint venture investments

		Fund's proportionate share of income before income tax	
Ownership Interest		Year ended December 31	Net assets December 31
		2001	2001
Valley Power Limited Partnership	50%	\$ 52	\$ 10,196
Campbellford Limited Partnership	50%	108	4,326
		\$ 160	\$ 14,522

The Fund acquired its interests in both entities during 2001.

#### 16. Subsequent event

On March 11, 2002, an entity of the Fund acquired, for approximately \$62,700, based on the Fund's average trust unit trading price, 86.7% of the outstanding trust units of KMS Power Income Fund and 47.3% of the outstanding principal amount of convertible debentures of KMS by issuing 6,099,557 trust units of the Fund. The Fund intends to exercise its rights under KMS' trust declaration and effect a subsequent acquisition transaction so as to acquire the remaining KMS trust units not tendered. This remaining acquisition will result in a further 713,616 trust units of the Fund being issued. KMS owns, directly or indirectly, four power generation facilities: an energy-from-waste facility in Ontario; two natural gas-fired co-generation facilities located in New Jersey and Illinois; and a landfill bio-gas-fired generating facility in Illinois.

## Trustees

R. Ian Bradley, *Chairman of the Trustees*

*Grand Toys International Inc., President and Chief Executive Officer*

George Steeves

*Energy Consultant*

Kenneth Moore

*NewPoint Capital Partners Inc., Managing Partner*

## Algonquin Power Management Inc.

Chris K. Jarratt, *Director and Chief Executive Officer*

John M.H. Huxley, *Director*

Ian E. Robertson, *Director*

David C. Kerr, *Director*

Peter Kampian, *Chief Financial Officer*

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## Registrar and Transfer Agent

CIBC Mellon Trust Company

320 Bay Street

P.O. Box 1

Toronto, Ontario M5H 4A6

## Annual General Meeting

Thursday, May 23, 2002, 4:00 p.m.

Blake, Cassels & Graydon LLP

23<sup>rd</sup> Floor, 199 Bay Street

Toronto, Ontario

## Stock Exchange

The Toronto Stock Exchange Symbol:

APF.UN

## Auditors

KPMG LLP, *Toronto, Ontario*

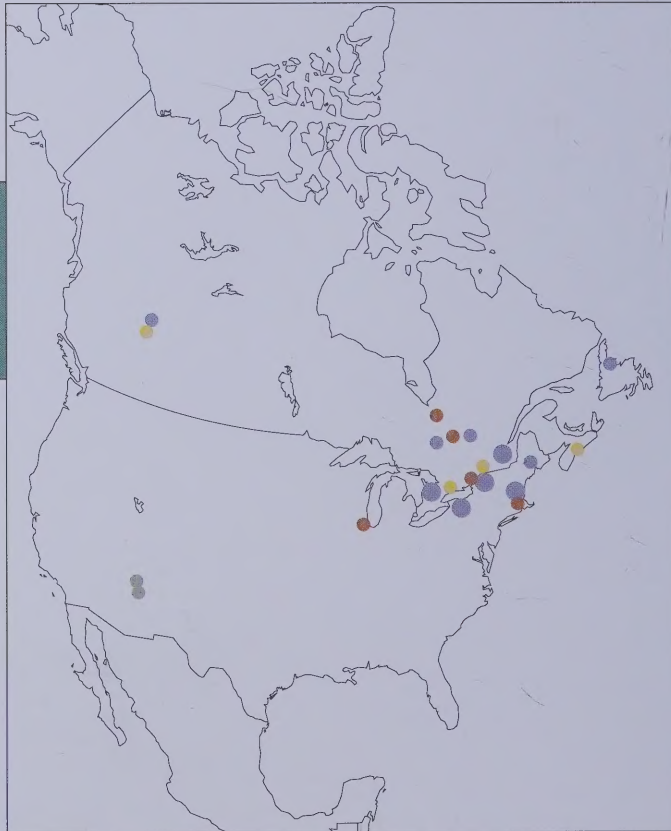
## Legal Counsel

Blake, Cassels & Graydon LLP, *Toronto, Ontario*

## GENERAL INFORMATION







● Hydroelectricity ● Alternative Fuel ● Natural Gas Co-generation ● Infrastructure